

RECENT DEVELOPMENTS

*Baxter International, Inc. v. Abbott Laboratories**

I. INTRODUCTION

In a recent decision out of the Seventh Circuit, the court—in an opinion authored by Judge Frank Easterbrook writing for the two-judge majority—ruled that under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards,¹ an arbitration panel's determination of antitrust issues under the Sherman Act could not be reargued in federal court on the grounds of mistake of law.²

II. BACKGROUND TO THE *BAXTER* DECISION

Well before the case under discussion here, the United States Supreme Court had already decided *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, in which the Court held that antitrust claims arising out of an international contract could be subject to determination under an arbitration agreement entered into by the parties.³ Therefore, it was settled that antitrust

* *Baxter Int'l, Inc. v. Abbott Laboratories*, 315 F.3d 829 (7th Cir. 2002).

¹ The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards [hereinafter Convention] was convened in 1958 to draft an international treaty that would resolve the difficulties found in the Geneva Protocol on Arbitration Clauses and the Geneva Convention on the Execution of Foreign Arbitral Awards. The United States became a signatory to the Convention in 1970. The purpose of the Convention is to promote the acceptance and enforcement of international arbitration clauses and awards and provide uniform standards for judicial communities in dealing with foreign arbitration agreements. For a good discussion of the background and purposes of the Convention, see Jill A. Pietrowski, *Enforcing International Commercial Arbitration Agreements: Post- Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 36 AM. U. L. REV. 57, 63–64 & nn. 33–36 (1986).

² *Baxter*, 315 F.3d at 831.

³ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 639 (1985) (holding that statutory antitrust claims arising from international contracts could be arbitrated consistent with the provisions of the Federal Arbitration Act). This decision represented a turning point from previous case law universally holding that antitrust claims could not be arbitrated. See DAVID W. RIVKIN, COMPETITION AND ARBITRATION LAW, THE U.S. SITUATION 129–30 (1993) (citing *American Safety Equipment Corp. v. J.P. Morgan & Co.*, 391 F.2d 821, 826 (2nd Cir. 1968) (holding that the public interest ramifications of the antitrust laws prevented antitrust claims from being resolved anywhere but in the courts) and *Gemco Latinoamerica, Inc. v. Seiko Time Corp.*, 671 F. Supp. 972 (S.D.N.Y. 1987) (holding that if a party wished to resolve a dispute under an

claims could be arbitrated,⁴ but the scope of review of an arbitration award in which antitrust issues had been resolved by an arbitral tribunal remained somewhat ambiguous after *Mitsubishi*.⁵ As a result of *Baxter*, the scope of review in the Seventh Circuit is now limited to whether or not the arbitral tribunal noticed that antitrust claims existed and whether the panel gave the claims a definitive resolution.⁶ Under the majority's opinion, whether the arbitrators resolved the antitrust claims *correctly* under the relevant antitrust statute is irrelevant.⁷

III. FACTS AND PROCEDURAL HISTORY

Baxter International, Inc. developed an anesthetic gas called Sevoflurane in the 1960s.⁸ Because the compound was difficult and expensive to produce, Baxter did not attempt to market it at that time but instead continued to search for an efficient process for producing Sevoflurane.⁹ Baxter succeeded in developing an efficient manufacturing process for Sevoflurane in the 1980s and promptly obtained two process patents encompassing the new process.¹⁰ Lacking the resources to pay for expensive tests required for Food and Drug Administration (FDA) approval of Sevoflurane, Baxter granted to Maruishi Pharmaceutical Company, a Japanese company, an exclusive

arbitration agreement, the party could assert its non-antitrust claims to arbitration but would have to bring the antitrust claims separately in federal court)).

⁴ This was not always the case. Half a century ago, the Court believed that rights under federal laws designed to protect the public could not be determined pursuant to arbitration because these claims were only appropriate to a judicial forum. The U.S. Supreme Court held that claims under the Securities Act of 1933 could not be determined pursuant to arbitration because "the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness." *Wilko v. Swan*, 346 U.S. 427, 437 (1953). The *Wilko* decision came down at a time when there was considerable hostility towards arbitration in general on the part of the judiciary. The hostility toward arbitration of claims under federal law began to erode in the 1970s as the Court began to issue decisions reversing the trend. *See, e.g., Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) (holding that claims under the Securities Exchange Act of 1934 could be submitted to arbitration when the arbitration agreement was part of an international commercial transaction).

⁵ *See Mitsubishi*, 473 U.S. at 638 (stating that "[w]hile the efficacy of the arbitral process requires that substantive review at the award-enforcement stage remain minimal, it would not require intrusive inquiry to ascertain that the tribunal took cognizance of the antitrust claims and actually decided them").

⁶ *Baxter*, 315 F.3d at 831-32.

⁷ *Id.* at 831.

⁸ *Id.* at 830.

⁹ *Id.*

¹⁰ *Id.* One patent has already expired and the other expires in December of 2005.

worldwide license to use the Sevoflurane manufacturing process Baxter had developed.¹¹ Maruishi obtained approval from the Japanese government to market Sevoflurane in that country, where it became a huge success.¹²

In 1992, Maruishi entered into a sublicensing agreement with Abbott Laboratories to shepherd Sevoflurane through the FDA approval process in the United States and begin marketing the anesthetic gas in this country.¹³ Under the agreement with Baxter, Maruishi remains the only manufacturer of Sevoflurane using the Baxter process patents.¹⁴ Abbott resells Sevoflurane that it has purchased from Maruishi under the sublicensing agreement, and Maruishi pays Baxter a royalty based on its total sales.¹⁵ At the time that Maruishi sublicensed with Abbott, Baxter-Maruisi and Abbott entered into a Dispute Resolution Agreement containing an arbitration clause.¹⁶ Any party who felt that another signatory to the agreement had caused impairment to the "Original Commercial Relationship" could invoke the Dispute Resolution mechanisms.¹⁷

Today, Sevoflurane is the most popular gas anesthetic on the market in the United States, holding a 58% market share.¹⁸ As Baxter's process patents covered only one way of manufacturing Sevoflurane, the drug's popularity gave other companies an incentive to develop another process for manufacturing Sevoflurane so that an alternative, generic form of Sevoflurane could be put on the market to compete with Abbott in the United States.¹⁹ In 1997, a company named Ohmeda began developing a new process, which it ultimately patented in 1999. Ohmeda planned to begin marketing a rival version of Sevoflurane, pending expedited approval by the FDA.²⁰

Before Ohmeda could bring generic Sevoflurane to market, however, Baxter acquired the company in a merger. Abbott Laboratories, distressed by the prospect of competition in the U.S. market, decided to dispute Baxter's ability to market the new Sevoflurane by initiating arbitration under the

¹¹ *Id.*

¹² *Baxter*, 315 F.3d at 830.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Abbott Lab. v. Baxter Int'l. Inc.*, No. 01 C 4809 Consolidated 01 C 4839, 2002 U.S. Dist. LEXIS 5475, at *3 (N.D. Ill. March 27, 2002).

¹⁷ *Id.*

¹⁸ *Baxter*, 315 F.3d at 830.

¹⁹ *Id.*

²⁰ *Id.*

Dispute Resolution Agreement on the grounds that Baxter was causing impairment to the "Original Commercial Relationship" by violating the exclusivity term of its license with Maruishi.²¹

The dispute was submitted to binding arbitration before a panel of three arbitrators, consisting of a U.S. attorney, a Spanish attorney, and a Japanese law professor.²² In response to Abbott's allegations, Baxter contended that if the license between Maruishi and Baxter prevented Baxter from competing in the market, then it violated Section 1 of the Sherman Antitrust Act by creating an illegal market allocation agreement.²³ The arbitral panel ruled against Baxter finding that the reduction in competition was due to Baxter's own actions in purchasing Ohmeda.²⁴ Because Ohmeda had never been a party to the Baxter-Maruisshi agreement, Ohmeda would not have been precluded from marketing its new Sevoflurane if Baxter had not acquired the company.²⁵ In other words, the only restraint on competition in the Sevoflurane market applied to Baxter and no other independent manufacturer.

Displeased with the outcome of the arbitration, Baxter filed a motion to vacate the arbitration award in the U.S. District Court for the Northern District of Illinois.²⁶ Abbott in turn filed a motion to confirm the award.²⁷ The district court granted Abbott's motion to confirm the arbitration award finding that under the New York Convention of the Recognition and Enforcement of Foreign Arbitral Awards (Convention), the arbitral panel's award was not contrary to U.S. public policy and could not be set aside on those grounds.²⁸ Namely, the Baxter-Maruisshi agreement did not violate the

²¹ *Abbott Lab.*, 2002 U.S. Dist. LEXIS, at *14–15. According to the district court, "Baxter's sales of a generic sevoflurane would constitute an impairment of the Original Commercial Relationship. As defined by clause (a) (iii), generic sales [would] 'reduce the amount a party would but for such change otherwise receive under any Sevoflurane agreement,' constituting an impairment." *Id.*

²² *Id.* at *12.

²³ *Id.* at *12, *18. Under the Sherman Act, an illegal market allocation agreement is a "horizontal allocation[] of territories or customers among actual or potential competitors." 15 U.S.C. § 1 (2000).

²⁴ *Baxter*, 315 F.3d at 831.

²⁵ *Id.*

²⁶ *Abbott Lab.*, 2002 U.S. Dist. LEXIS 5475, at *1.

²⁷ *Id.*

²⁸ *Id.* The United Nations Convention of the Recognition and Enforcement of Foreign Arbitral Awards provides for only limited grounds for vacating an arbitration award, one of which is that "[t]he recognition or enforcement of the award would be contrary to the public policy of the country in which the award is sought to be enforced." See RUSSEL J. WEINTRAUB, INTERNATIONAL LITIGATION AND ARBITRATION 71 (3d ed. 2001).

Sherman Act or any other U.S. antitrust policies.²⁹ Baxter then appealed to the Seventh Circuit Court of Appeals, which affirmed the District Court's decision.³⁰ Judges Frank H. Easterbrook and John L. Coffey comprised the majority, while Judge Richard A. Cudahy dissented.³¹

IV. THE COURT'S HOLDING AND RATIONALE

The district court went to great lengths to discuss the merits of Baxter's antitrust violation argument in its opinion, finally concluding that the Baxter-Maruishi contract posed no antitrust problems. The appeals court, however, did not even begin to address the substance of Baxter's antitrust claims. According to the majority, a potential error in applying a statute is not reason enough to set aside an arbitral award under the Convention. As Judge Easterbrook writes:

Baxter argues at length in this court that the Baxter-Maruishi license, construed [by the arbitral tribunal] to keep the Ohmeda-process sevoflurane off the U.S. market until 2006, is a territorial allocation unlawful *per se* under § 1 of the Sherman Act. But the initial question is whether Baxter is entitled to reargue an issue that was resolved by the arbitral tribunal. We think not; a mistake of law is not a ground on which to set aside an award.³²

The court states that an arbitration award that disposes of antitrust issues should not be easily challenged under the Convention because "to throw the result in the waste basket and litigate the antitrust issues anew . . . would just be another way of saying that antitrust matters are not arbitrable."³³ According to the court, such a result would be contrary to the Supreme Court's holding in *Mitsubishi*.³⁴

Baxter argues, however, that it is not attempting to reargue the antitrust issues. Rather, Baxter claims that the arbitral panel *created* the antitrust problems by construing the Baxter-Maruishi agreement in a way as to grant strong exclusivity to Maruishi—and Abbott by extension.³⁵ According to Baxter, if the arbitrators had interpreted the agreement differently, there never would have been any antitrust issues over which to litigate. The

²⁹ *Abbott Lab.*, 2002 U.S. Dist. LEXIS 5475, at *30, 36–38.

³⁰ *Baxter*, 315 F.3d at 833.

³¹ *Id.* at 829.

³² *Id.* at 831.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

Seventh Circuit court disregards Baxter's argument by stating that under the *Mitsubishi* standard, all the arbitrators had to do was recognize the antitrust claims and decide them, which they did.³⁶ As Judge Easterbrook writes, "[t]he arbitral tribunal in this case 'took cognizance of the antitrust claims and actually decided them.' Ensuring this is as far as our review legitimately goes."³⁷

The final point of the majority's opinion addresses what recourse the public might have if, in fact, the Baxter-Marubishi agreement does create a monopoly. According to the court, "[i]f the three-corner arrangement among Baxter, Marubishi, and Abbott really does offend the Sherman Act, then the United States, the FTC, or any purchaser of sevoflurane is free to sue and obtain relief."³⁸ The court then said that an appropriate remedy might be divestiture of the Ohmeda process patent.³⁹

V. THE IMPACT OF THE COURT'S DECISION

The *Baxter* decision represents the next in a line of decisions in which the general climate favoring arbitration has been extended just a little bit further. It remains to be seen whether other circuit courts will follow the Seventh Circuit's holding in *Baxter*. Also at issue is whether the holding will be extended to cover arbitration of antitrust claims in purely domestic arbitration agreements. U.S. Supreme Court decisions after *Mitsubishi*, in which the Court decided domestic disputes involving federal securities laws and RICO claims are arbitrable, indicate that the *Baxter* holding would almost certainly be extended similarly.⁴⁰

The impact of this decision lies in the extreme amount of deference given to an arbitration award that interprets a federal statute, even when the award might be based on an incorrect interpretation of that statute and thus

³⁶ *Baxter*, 315 F.3d at 832.

³⁷ *Id.*

³⁸ *Id.* The dissent was not impressed with the majority's proposed remedy. As Judge Cudahy explains, the majority's other potential "sources of law enforcement . . . are all hypothetical. I know of no authority for the theory that the existence of hypothetical sources of antitrust enforcement or of competition can be a defense to an agreement violative of the antitrust laws or to an arbitration award imposing such an agreement." *Baxter*, 315 F.3d at 838-39 (Cudahy, J., dissenting).

³⁹ *Baxter*, 315 F.3d at 833.

⁴⁰ See *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 239 (1987) (holding that the reasoning in the *Mitsubishi* decision was applicable to the arbitration of securities law and RICO claims in a purely domestic dispute); *Rodriguez De Quijas v. Shearson/American Express Inc.*, 490 U.S. 477, 484 (1989) (expressly overruling *Wilko* and holding that claims under the Securities Act of 1933 in a domestic context were arbitrable.); RIVKIN, *supra* note 3, at 132-34.

permitting illegal conduct on the part of the parties to the agreement. As Judge Cudahy explains in his dissenting opinion, “under the majority’s analysis, the rule that unlawful conduct cannot be commanded by arbitrators is consumed by the exception that, if arbitrators themselves say that what they have commanded is not unlawful, then ‘their answer is conclusive.’”⁴¹ This decision goes beyond saying, as *Mitsubishi* did, that antitrust claims are arbitrable; it goes on to say that the arbitration panel’s answer is the final answer and for all practical purposes indisputable and absolute.⁴²

VI. CONCLUSION

With statutory claims in which public protection is the primary aim of the law, the Seventh Circuit’s decision in *Baxter* is arguably dangerous. In the system of traditional litigation, there is always the safeguard of appeals to ensure that the trial court got the answer right the first time around. In an arbitration in which the panel’s answer is accepted as final and binding, there is little recourse for a party who gets stuck with a wrong answer.⁴³ This might not be such a terrible result if the wrong answer affected only the parties to the agreement. However, when the effects spill over into areas of public concern such as antitrust, it is not just the parties who will suffer the price of a wrong answer.⁴⁴ Indeed, some scholars of antitrust law argue that

⁴¹ *Baxter*, 315 F.3d at 836.

⁴² *Id.*

⁴³ *Id.* (Cudahy, J., dissenting). According to Judge Cudahy:

While *Mitsubishi* and its progeny make clear that the choice of arbitral forum is to be respected, they do not confer on the arbitrators a prerogative to preemptively review their own decisions and receive deference on that review in subsequent judicial evaluations. The majority is way off-base when it says that *Baxter* seeks merely to have us disregard the panel’s decision and “throw the result in the waste basket.” Instead, *we are performing exactly the traditional function of judicial review properly assigned only to us.*

Id. (emphasis added).

⁴⁴ *Id.* at 838. Judge Cudahy writes:

It is, of course, not the interests of the parties themselves that are primarily at stake in the outcome of this arbitration. Instead, the interest of the consuming public is at stake. That public faces higher prices and a constrained supply of sevoflurane as a result of Abbott’s monopoly, conferred by the arbitrators. When public rights are at stake, there is good reason to be more reluctant to defer totally to the arbitrators, since they are acting as delegates of the private parties, not of the consuming public. Too deferential an attitude by the courts when the rights of the consuming public are at stake can severely undermine the foundations of our economy. For there can be little doubt that granting Abbott a monopoly to produce sevoflurane in the United

“[t]he only legitimate goal of American antitrust law is the maximization of consumer welfare.”⁴⁵

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States will raise prices and restrict supply. And applying the analysis of the majority to arbitration awards yet to come will open a royal detour around the antitrust laws.

Id.

⁴⁵ F.M. Scherer, *Efficiency, Fairness, and the Early Contributions of Economists to the Antitrust Debates*, in COMPETITION POLICY: DOMESTIC AND INTERNATIONAL 15 (2000) (quoting ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978)).